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**REVIEW OF WHOLESALE  
ELECTRIC MARKET DESIGN**

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**BEFORE THE  
PUBLIC UTILITY COMMISSION  
OF TEXAS**

**JOINT RETAIL ELECTRIC PROVIDERS'  
RESPONSES TO COMMISSION QUESTIONS**

## **JOINT REPS' EXECUTIVE SUMMARY**

- The LSE Obligation will not solve the wholesale market reliability issues that were encountered in Winter Storm Uri.
- The LSE Obligation is a very complex way to attempt to direct financial incentives to dispatchable resources. It has not been successfully implemented in any market that has robust retail electric competition.
- There are other more targeted proposals that if adopted would direct financial incentives to dispatchable resources that can be implemented more quickly, at a lower cost to customers, and will not harm or reduce the competitive retail options available to customers.

### **Recommended Approach**

#### **1. Lower Price Cap**

- Dampen factor contributing to price volatility that could result in future catastrophic financial events.
- Study and implement appropriate Operating Reserve Demand Curve (“ORDC”) adjustments to preserve and enhance price signals to dispatchable resources

#### **2. New Reliability Services to Manage Intermittency and Extreme Weather**

- Establish a weather-qualified reliability service to be procured by ERCOT on a system-wide basis through auction mechanisms with settled market prices
- Auctions tend to encourage bilateral market liquidity by creating price discovery and addressing market power
- Provide for a cost-recovery mechanism that allows LSEs to pass-through the new and incremental costs of these regulatory actions to customers with fixed-price contracts entered into prior to the implementation of any new reliability services.

#### **3. Emergency Pricing Program**

- SB 3 requires that the Commission establish an emergency pricing program
- Under this program, the Commission can establish triggers that would suspend market, move to cost-based, command and control operations
- This would remove disaster operations from the market model and relieve regulatory uncertainty.

### **LSE OBLIGATION SPECIFIC ISSUES**

The LSE Obligation as proposed is not consistent with the unbundled competitive retail electric market in Texas.

- At its core, the LSE Obligation says that REPs should buy or construct generation capacity if they do not have a contractual physical hedge. This is in direct contravention of Public Utility Regulatory Act that prohibits REPs from owning generation.

- The bilateral nature of the LSE Obligation proposal raises serious market power concerns. The ownership of centralized dispatch generation is concentrated in a handful of power generation companies (all of whom have affiliated retail electric providers). Accordingly, a large concentration of the Reliability Tokens will not be available because these entities will have no economic incentive to sell the Tokens to their competitors at a reasonable cost.
- These market power issues would result in suppression of the competitive retail electric market that brings innovation and price suppression to all customers in ERCOT.
- If an LSE Obligation were to be considered in any respect, it would have to include a must offer centralized procurement of Reliability Tokens through an auction held by ERCOT. The cost of those Tokens would then need to be assigned to actual load for each operating day.
- The LSE Obligation Proposal relies on a forward forecast by load-serving entity to be performed by ERCOT. (ERCOT just confirmed in testimony in the securitization cases that it does not have the systems in place to do a forward forecast even for municipally-owned utilities and electric cooperatives; an exercise many orders of magnitude simpler than doing such for each competitive retail electric provider.)
- LSE Obligation proposals have been previously reviewed and rejected for the Texas competitive market. (e.g. Brattle Report).

There is no successful implementation of an LSE Obligation in a comparable competitive retail electric market:

- The other US markets on which E3 relies as examples are not relevant comparisons.
  - Physical bilateral matching of supply with retail obligations is less of an issue in these regions than it would be in Texas because the participants are largely vertically integrated monopoly utilities who have relatively matched generation and load by design and legacy. The designs themselves do not have to contemplate robust load switching and competition.
  - Notes on other ISOs: California has very limited customer choice, MISO is only restructured in Ameren and Michigan. Both MISO markets still have auctions. Michigan has a similar LSE obligation (retail providers must show physical capacity supply years ahead), and it is almost impossible to find a forward supply of capacity to meet this obligation, especially when layering in potential credit limitations associated with bilateral contracts, thus very low levels of competitive penetration.
- The Australian Retailer Reliability Obligation program is unproven and complicated. It also has very complex market power mitigation measures that are not put forth in the E3 proposal.
- Load Obligation was tried in PJM and was ultimately rejected in favor of a standard capacity market.

## RESPONSES TO COMMISSION QUESTIONS

Pursuant to the memo from the Public Utility Commission of Texas (“PUC” or “Commission”), Just Energy, AP Gas & Electric, Young Energy, LLC and Demand Control 2, LLC (“Joint REPs”) file these comments on market design issues under discussion at the PUC. These responses offer some perspective from some Retail Electric Providers (REP) with regard to wholesale market design implementation and the effect on customers. Accordingly, the responses offered here are provided from the perspective of maintaining and enhancing the benefits available to customers from a robust competitive retail electric market.

- 1. The ORDC is currently a "blended curve" based on prior Commission action. Should the ORDC be separated into separate seasonal curves again? How would this change affect operational and financial outcomes?*

The Commission can use the ORDC to create appropriate price signals to incent the adequacy of dispatchable generation. The exact shape of the curve to create the appropriate price signals will require specific studies and analysis that are available using data housed at ERCOT.

- 2. What modifications could be made to existing ancillary services to better reflect seasonal variability?*

Existing ancillary services could be procured in quantities that vary more by season. Under standard protocols, the procurement quantities are scheduled by month and approved by the ERCOT Board. The quantities could easily include more seasonal variation. However, to the extent these adjustments are made by season, the adjustments should be approved in the annual scheduling of ancillary services. Any new ancillary services, material changes in the annual procurement schedule of existing services compared to prior years, or modifications to existing services that exceed the annual procurement schedule made during the pendency of existing customer contracts should be procured by ERCOT on a system-wide basis with changes in the most reasonably advanced notice as practical and with the ability for LSEs to recover incremental costs on contracts signed prior to the knowledge of and implementation of the changes.

3. *Should ERCOT develop a discrete fuel-specific reliability product for winter? If so, please describe the attributes of such a product, including procurement and verification processes. a. How long would it take to develop such a product? b. Could a similar fuel-based capability be captured by modifying existing ancillary services in the ERCOT market?*

A resiliency product that could have weather resistant reliability could be established. It is important that the description of any such product be performance based to express weather conditions rather than specifying the fuel or exact technology.

Any newly designed ancillary service with a limited number of suppliers who qualify to offer the service should be procured by ERCOT on a system-wide basis through competitive auction with changes in the most reasonably advanced notice as practical and with the ability for LSEs to recover incremental costs on contracts signed prior to the knowledge of and implementation of the changes.

4. *Are there alternatives to a load serving entity (LSE) Obligation that could be used to impose a firming requirement on all generation resources in ERCOT?*

Explicit generation types meeting firming “Obligations” are not practically any more firm than forward physical (firm) power purchases that would be procured with LSE Obligation requirements. Such an Obligation (whether on LSEs or Generation) is an additional more long-term revenue stream to incentivize generation regardless of whether they necessarily sell energy on the grid to be delivered to end-use customers. These same revenue enhancements can be achieved through a more targeted performance-based reliability service that compensates those dispatchable resources that are available to address the fluctuations in net load.

5. *Are there alternatives to an LSE Obligation that could address the concerns raised about the stakeholder proposals submitted to the Commission?*

Yes. Rather than changing the market design to an LSE Obligation, a combination of the following could address many of the concerns raised by stakeholders and increase reliability in the ERCOT region.

1. Lower price cap along with appropriate adjustments to the ORDC
2. New reliability services to manage intermittency and extreme weather. Procured by ERCOT through an auction mechanism with settled market prices that can still be self-supplied and hedged bilaterally.
3. Instituting an Emergency Pricing Program for disaster events where a market-based model is not solving the operational issues, so the current crisis-based market model would be avoided. Under this new program, in the event of a crisis, the market would be suspended, transitioning to a cost-based mechanism, and ERCOT would have the command and control authority to most efficiently operate through the disaster.

6. *How can an LSE Obligation be designed to protect against the abuse of market power in the wholesale and retail markets?*

The LSE Obligation would require a must-offer centralized auction mechanism which allows competitively neutral acquisition of the Reliability Tokens. These Tokens equate to the reserve margin of dispatchable resources that are determined to be necessary by ERCOT or the Commission. There also must be appropriate market power protections on the ability to offer these Tokens and the ability to withdraw offers of such. While this centralized clearing would address some of the market power concerns, it does not address the concerns regarding control of the Tokens dampening the options available to customers as they seek to shop and look for competitive contract options after the period in which the Tokens have been assigned by auction.

- a. *Will an LSE Obligation negatively impact customer choice for consumers in the competitive retail electric market in ERCOT? Can protective measures be put in place to avoid a negative impact on customer choice? If so, please specify what measures.*

Yes, this ultimately will negatively impact customer choice by limiting competition and creating larger barriers to entry and growth. A market design that requires acquisition of a capacity product without a spot market or forward must-offer auctions likely would result in liquidity issues as well as supply withholding. Poor liquidity and supply withholding to either exert market power, or just because of uncertainty in affiliated retailer projected demand, would result in an inefficient market and ultimately reduce competitive options and product offerings for the customer.

Moreover, an LSE obligation would impair the current valuable wholesale market in ERCOT, consisting of large wholesale intermediaries capable of crafting the types of wholesale products that unaffiliated retailers need in order to serve retail load reliably and cost-effectively. These intermediaries provide liquid physical and financial products, including credit, that have not been generally available directly from generators, yet generally are backed by the intermediaries' transactions with large generation owners. Thus, the current market consisting of QSE/LSE transactions with a wholesale intermediary QSE, in turn backed by a generation QSE transaction produces the same result as a QSE obligation, but for the capacity market-like payment. Virtually every unaffiliated retailer in the ERCOT market has relied on and benefited from the liquidity and credit support of wholesale market intermediation that will be impaired by a direct LSE Obligation model.

New REPs who are entering the market have hedging products available to cover their energy obligations, and REPs enter into those hedges to cover customer contracts as they build their customer base. However, on a three year forward basis, a REP entering the market would not have the ability to effectively estimate their customer base three-years forward, and it is unclear that there would be a mechanism to allow that REP to acquire Reliability Tokens that are commensurate to their growth in customers. This mechanism would serve as a tremendous barrier to entry to new and innovative REPs seeking to enter this market. This loss of access to liquidity and credit support coupled with a generally constrained access to credit following Winter Storm Uri means that competitive REPs will be limited in their ability to participate in the market if an LSE Obligation is imposed.



- b. *How can market power be effectively monitored in a market where owners of power generation also own REPs that serve a large portion of ERCOT's retail customers?*

There must be a decoupling of the Reliability Tokens from the generation resource. To control market power, forward must-offer centralized auctions would be required. In addition, any holder of excess Reliability Tokens would need to offer them into a spot market or near-term auction to allow customers to shop freely and move among REPs on a competitive basis.

- c. *What is the impact on self-supplying large industrial consumers who will have to comply with the LSE Obligation and will it impact their decision to site in Texas?*

This requirement to meet an LSE Obligation could dampen the ability of large industrial loads moving to Texas because such entities would be exposed to the risk of difficulty in procuring Reliability Tokens in a quantity to match an uncertain build out of load or modifications to existing industrial sites. This adds an uncertainty that does not exist today and there would likely be a fear of non-performance penalties on unproven new sites and expansions of existing sites.

- d. *What is the impact of an LSE Obligation on load-serving entities that do not offer retail choice, such as municipally owned utilities or electric cooperatives?* No comment.

- e. *Can market power be monitored in the bilateral market if an LSE Obligation is implemented in ERCOT? Can protective measures be put in place to ensure that market power is effectively monitored in ERCOT with an LSE Obligation? If so, please specify what measures.*

In a completely bilateral market, market power cannot be effectively monitored and mitigated. There are dynamics in bilateral-only markets that can cause sellers to take advantage of the inefficient market. Offers can exceed theoretical unit costs of building new dispatchable generation. The buyer may be forced to procure to avoid penalties that are multiples of what it costs to build, because building generation may not be practical or possible for that individual entity. Further, to try to mitigate market power without auctions, counter parties may be forced to sell to other counter parties, and subsequently have forced exposure to their credit. In addition to the regulatory bureaucracy that would

be required to implement this program, this ultimately results in higher costs for customers because of an inefficient market.

*f. Should the LSE Obligation include a "must offer" provision? If so, how should it be structured?*

Yes, if an LSE Obligation were considered, a must offer provision on all generators would be a necessary element. The must-offer provision would need to be structured such that the capacity sold under the LSE Obligation is compelled to be publicly offered to all LSE's to avoid market power control. Further, the resources which receive accreditation would be required to offer into the energy market at all times, other than periods for which maintenance outages are scheduled.

*7. How should an LSE Obligation be accurately and fairly determined for each LSE? What is the appropriate segment of time for each obligation? (Months? Weeks? 24-hour operating day? 12-hour segments? Hourly?)*

Any LSE obligation or any other reliability product should be a function of an LSE's actual usage in the delivery period for which the capacity product or reliability service is trying address a need, as opposed to some projected LSE-level forecast that is not directly tied to the forecasted load of the retail customers under a contract at the time a forward LSE Obligation is determined. There is not a way to prove or adequately forecast forward obligations on an individual LSE basis. Additionally, fixed forward LSE obligations at annual, semiannual or monthly intervals do not address the most important obligation of all, which is the intramonth, weekly and daily load following obligations that occur coincide with the periods of greatest system stress. Finally, penalizing LSEs due to actual loads that are greater than erroneous forecasts by ERCOT of forward LSE Obligations is not appropriate.

*8. Can the reliability needs of the system be effectively determined with an LSE Obligation? How should objective standards around the value of the reliability-providing assets be set on an on-going basis?*

- a. Are there methods of accreditation that can be implemented less administrative burden or need for oversight, while still allowing for all resources to be properly accredited?*
- b. How can winter weather standards be integrated into the accreditation system?*

The reliability needs of the system cannot be effectively determined with the LSE Obligation alone. The obligation does provide an additional revenue stream as an incentive to whatever technologies are dispensed Reliability Tokens, like a capacity market, but does not guarantee performance at critical times nor does it guarantee the building of generation that can be deployed to meet the fluctuations in net load that create operational concerns. To establish objective standards around the value of the assets, extensive studies need to be undertaken that would likely result in an output subject to major stakeholder debate. The evaluation and studies would need to be on-going to adapt to the rapidly changing technology and market landscape to try to effectively curate and design the generation mix outside the wholesale markets of energy market and ancillary or reliability services.

*9. How can the LSE Obligation be designed to ensure demand response resources can participate fully and at all points in time?*

Demand response needs to be treated consistent with dispatchable resources. Further, the subjectivity of when and how load resources can be considered as qualifying as dispatchable resources should not be changed in an ad hoc manner once the program is operations.

*10. How will an LSE Obligation incent investment in existing and new dispatchable generation?*

It creates an incremental revenue stream, like a capacity market, but at the expense of energy market prices and forward volatility that generation previously relied upon to monetize value.

*11. How will an LSE Obligation help ERCOT ensure operational reliability in the real-time market (e.g., during cold weather events or periods of time with higher than expected electricity demand and/or lower than expected generation output of all types)?*

As with a capacity market or other reliability service, this could provide an added revenue stream to incentivize generation to be online, but does not guarantee performance due to other issues, like mechanical and fuel supply/natural gas infrastructure-related issues. The incentive to be online in the real-time market would be related to potential penalties for not delivering. The LSE Obligation itself does not incent real-time participation other than through the penalty mechanism.

*12. What mechanism will ensure those receiving revenue streams for the reliability services perform adequately?*

Meaningful penalties for non-performance must be in place.

*13. What is the estimated market and consumer cost impact if an LSE obligation is implemented in ERCOT? Describe the methodology used to reach the dollar amount.*

With a generation shortage likely to be projected, cost expectations should be reflective of the volume and unit price to build a new dispatchable plant (“Cost of New Entry”). All resources, although with varying volumes, would get a unit price reflective of this, similar to a capacity market, to incentivize them from not retiring. Inefficient generation that will now be less likely to retire, resulting in higher overall system cost.

*14. How long will the LSE Obligation plan take to implement?*

It would take many years to complete the adequate level of due diligence and analysis around how processes would functionally work, such as determining the reliability value of each resource type on an on-going basis, determining the LSE obligations themselves in a way that accommodates retail switching, and designing controls to check market power. Then it would take a transition period to actually launch the redesigned market. Though a 5 year implementation period may be possible, that timeline would be aggressive.

*15. If the Commission adopts an LSE Obligation, what assurances are necessary to ensure transparency and promote stability within retail and wholesale electric markets?*

If the Commission adopts an LSE Obligation, the commission should require the following in order to ensure transparency and promote stability within the ERCOT retail and wholesale electric market:

- Provide both a timetable and clear and detailed plan forward as soon as possible to protect market liquidity.
- An auction mechanism where generators must offer, in contrast to a solely bilateral market
- Clearly establish these market re-designs as change-in-law to enable cost recovery on existing retail contracts.
- The LSE obligation needs to be determined and cleared in an auction at an ERCOT-level and then allocated to LSEs based on their actual demand in a delivery period or the forward obligation of the LSE needs to be a function of actual customer demand of contracted retail customers, not a forecasted LSE-level obligation that restricts competition.

*16. Are there relevant "lessons learned" from the implementation of an LSE Obligation in the SPP, CAL-ISO, MISO, and Australian markets that could be applied in ERCOT?*

None of these examples have successfully implemented an LSE Obligation in a market that has robust retail competition.

Australia is the most competitive market that is attempting to implement this program; however, it is not yet implemented and in the development phase the program design continues to add complexity to this unproven program.

The other examples provided do not have robust retail competition. The Resource Adequacy program in California had the effect of further reducing the limited competition that had been in place in that market.

In addition, PJM tried to implement a Load Obligation program but found that the market power and lack of liquidity did not make the effort successful. This led to the centrally cleared capacity market that exists in PJM today.

The lessons learned can be summarized as follows:

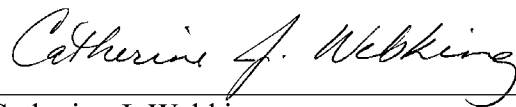
Transparent forward auctions are critical to checking market power. Completely bilateral markets with no auctions or spot settlements are not efficient and can result in situations with virtually no liquidity, reduced competition, and excess cost to customers.

Price discovery created through a forward auction is critical to stimulating liquidity in bilateral markets. This occurs in PJM, NYISO, ISONE, and MISO.

Creating a forward obligation that is disconnected from forward retail contracts or actual LSE demand is harmful to the retail market competition and will have residual negative impacts to customer access to longer contract tenors and prices as premiums to cover uncertainties and disconnects will need to be priced in to retail contracts.

Similar market-designs are burdensome to administer, inefficient as a wholesale market design, and subject to regular and on-going disputes about volumetric obligations of LSEs.

Respectfully submitted,



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ON BEHALF of JOINT REPs

Per Staff's instructions, the Executive Summary is also attached here.

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